1812

THE FIRST NATIONAL CITY BANK OF NEW YORK EST. 1812

1956

First National City Bank Monthly Letter

Business and Economic Conditions

New York, January, 1956

General Business Conditions

THE nation has ended its busiest and most prosperous year with the indexes of over-all business activity at the highest of the year. Latest figures on production, nonfarm employment, consumption, income, and investment indicate that the trend is still upward. In some lines of industry output has ceased to expand only because it is bumping against the ceiling of capacity. In the exceptional cases where slackening of demand is reported, seasonal influences, whose weight is always difficult to appraise, are at least partly responsible.

Although business activity has increased without even a temporary reversal for nearly a year and a half, and it would be unreasonable to expect growth to continue at the recent extraordinary rate, the momentum derived from well-filled order books and expanding investment programs will carry the economy into the opening months of 1956 at record levels. More people are at work in this country than ever before.

CONTENTS

By any practical definition, employment is full, and overtime work is frequent. Workers are now turning out goods and services at a rate which is approaching $400 billion annually, compared with total output of $360.5 billion in 1954. Personal incomes and purchasing power have increased to all-time peaks. People have bought freely, augmenting their own resources by borrowing, and living standards, already high, have risen to new heights. Corporations are reporting their best peacetime profits, and increased dividends doubtless have helped make Christmas retail sales the highest, by a good margin, in the country's history.

Along with this activity go feelings of optimism and well-being. It may be added that the prosperity which the United States is enjoying exists not only across the nation but also throughout much of the free world. This is by no means the only country that can call 1955 its record year.

The 1955 Gains

A year ago most observers were optimistic; the consensus was that 1955 would be a good year. Few, however, thought it would be a record breaker. The actual year-to-year expansion of 9 per cent in total output of goods and services and 7 per cent in disposable income, as shown by latest figures, is considerably greater than most people expected and more than double the economy's long-term average rate of growth.

The gains of 1955 were all in the private sector; government expenditures scarcely changed. The under-estimates of the prospect stemmed essentially from under-estimates of consumer expenditures and the willingness of people to borrow and buy. The actual turn upward in the business indexes in the fall of 1954 was attributable more to the end of inventory liquidation and the resulting lift in orders and production than to any other single factor. But consumers, whose expenditures had risen

throughout 1954, carried on the advance with their enthusiastic response to the new '55 passenger automobiles and to the new houses that many could buy on easier terms.

In 1955 people spent still more liberally, as the increased purchasing power growing out of higher production and employment flowed around the circle, each industry in effect supporting the others. As the year progressed family incomes rose steadily because of rising employment, longer hours, and a round of sizable wage increases. When people encountered attractive new cars, homes or appliances, competitively priced and aggressively sold, they were willing buyers. Purchasing power was supplemented by large injections of consumer and mortgage credit, which according to latest figures show a year-to-year expansion of $5.7 billion and $12 billion respectively.

Credit sales on easy terms largely explain why sales of autos and other consumer goods so greatly exceeded expectations. By early 1955, new car buyers in many cases could take 36 months or more to pay, and a veteran could buy a home on a 30-year mortgage with little or no equity. With less cash down and lower monthly payments than had previously been possible, more people found a new car or house within their reach. Some families added to their debt or drew down their savings faster than other families added to their assets. On the whole, consumers saved less than 6 per cent of their disposable income in 1955, in contrast to the 1951-54 rate of nearly 8 per cent.

The extension of debt to be repaid out of future income is traditionally associated with the purchase of goods which will provide services over an extended period of time, in this case consumer durable goods and homes. At latest reports, such outlays were at an annual rate one-fourth greater than in 1954, but expenditures on nondurable goods and services were up only 5½ per cent. The rise in the latter category represents a modest growth in per capita consumption, but the real advance in living standards arises from the use – now and in the years to come – of the $62 billion or more of durable goods and homes purchased in 1955.

With attractive products, strong selling effort and receptive markets, automobile manufacturers turned out in 1955 nearly 8 million passenger cars, 45 per cent more than in 1954 and one-fifth more than in the previous record year of 1950. Production of major household goods rose one-fifth to a new all-time peak. By way of comparison, the over-all rise in industrial production from 1954 to 1955 was about 12 per cent.

Inventory and Investment Demand

Business spending as well as consumer spending has supported the recovery. The buildup of inventories during 1955 has been held back by short supplies and commendably cautious purchasing policies. At the same time the record volume of sales to consumers and business, the steadily rising rate of industrial activity, and lengthening delivery dates have maintained pressure for larger working stocks throughout the year. Despite an increase of some $4 billion in business inventories during the year, many businesses still feel the need for selective increases in their stocks, and further accumulation is anticipated in early 1956.

Most importantly, the pressure of demand against capacity led promptly to a marked increase in business men's plans for plant and equipment expenditures. By the fourth quarter of 1955, business capital outlays had reached a new record rate of $31 billion annually, 18 per cent greater than a year earlier. An impressive further increase in capital investment is already scheduled for 1956.

The lesson of the sharp rise in purchases of new plant and equipment is that, despite the substantial capital investment which has taken place in recent years, business men find it necessary to invest heavily if they are to keep up with competition. They feel the need for modernizing facilities to improve efficiency and cut costs, and, in many cases, for expanding capacity and developing new products to keep pace with growing markets. Technological changes are stimulating business investment much as new models stir up consumer demand. Last September the metal-working machinery industry held its first trade show in five years; the showing of new and improved models there has been followed by a sharp increase in new orders.

Entering a $400-Billion Economy

As we enter 1956 we stand – in the words of Dr. Arthur F. Burns, Chairman of the Council of Economic Advisers – "at the threshold of a 400-billion-dollar economy". At present there are no convincing signs of an early or sharp downturn in business in the aggregate, and many signs that expansion is continuing. On the other hand, we cannot long maintain the 1955 rate of growth, which already has us bumping against the limits of materials, labor supply, and industrial capacity. What seems the most likely and desirable prospect is a check to the rise and a period of relative stability. As was the case in 1954, stability does not imply stagnation, but a mixture of changes upward and downward as

required in individual lines. The need now is for a leveling-off period in which to digest our gains, check the borrowing of demand from the future, and correct any maladjustments which may have arisen during the rapid advance.

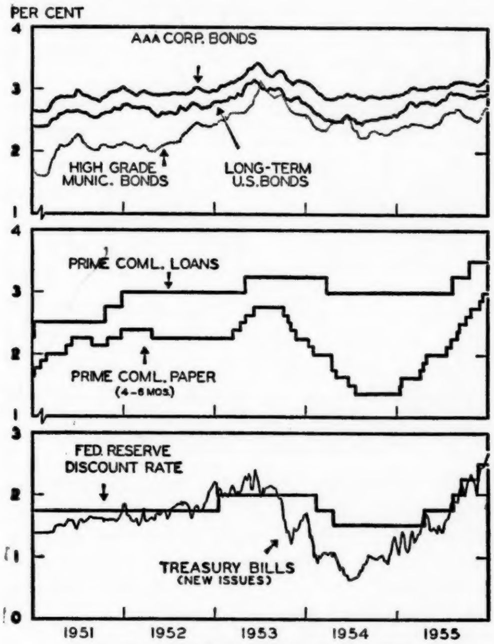
The chief source of strength in early 1956 will be the scheduled increase in business capital investment. The heavier demand for producers' goods, which has built up good backlogs of unfilled orders, will act as an offset to any easing in consumer demand. Business sentiment recognizes that no fresh stimulus can be expected from automobiles and housing in 1956; they are unlikely to contribute as much support to the economy as in 1955. Mr. Curtice of General Motors expects a 12 per cent decline in passenger car production. Virtually all housing experts anticipate that the number of homes built in 1956 will be fewer than the 1 1/3 million started in 1955, although there may not be much further drop from the present rate of about 1.2 million a year.

To maintain the state of well-being achieved in 1955 and carry on its economic progress, the economy in 1956 must walk a tightrope – maintaining an uneasy equilibrium at a high level between inflation on the one hand and deflation on the other. The problems of prosperity include the pressures on prices, the inefficiencies and bottlenecks, and the ebullient optimism which accompany near-capacity operations. It is possible that the very real advances in welfare during 1955 could give way to illusory gains compounded of rising prices, involuntary accumulation of inventories, and over-extended credit. The economy does not yet show convincing signs that excesses have reached dangerous proportions, nor are they in any sense inevitable, but they could develop if we substitute enthusiasm for caution and emphasize prosperity to the extent that we forget its problems. The biggest problem of all is to slow down to a sustainable rate of growth without going through a cycle of boom and bust.

Credit Developments

Money market developments in December followed pretty much the normal seasonal pattern. Currency circulation, along with retail trade, reached its 1955 peak on the eve of Christmas. Bank loans also touched their year's peak as the manufacturer borrowed to finance the retailer and the retailer borrowed to finance increased inventories and customer charge accounts. Completing its seasonal deficit-financing program, the Treasury on December 15 borrowed $1½ billion through the sale of Treasury bills in anticipation of corporation income taxes due March 15. Symptomatic of the pressures for funds on the banks and business community, open market money rates edged higher.

Yields on 91-day Treasury bills, which had reached 2.45 per cent at the close of November, moved up beyond the Federal Reserve's 2½ per cent discount rate to 2.69 per cent on the issue dated December 29. During the month prime 90-day bankers acceptances were marked up ¼ to 2½ per cent and prime 4-6 months commercial paper ⅛ to 3 per cent.

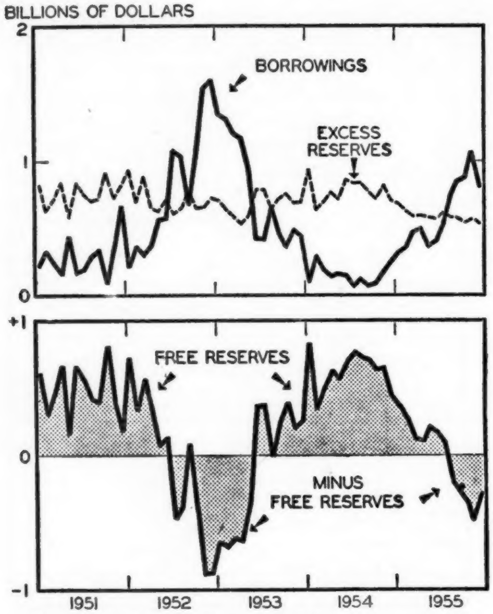


Money Rates and Bond Yields, Weekly, 1951-55

All of these rates were the highest since 1933, measuring the force of credit demands as well as the retreat of the Federal Government from the inflationary cheap money policies adopted in that year and carried forward during and after World War II.

The Federal Reserve, which had advanced the discount rate another ¼ per cent in November, employed open market purchases of government securities on a fairly heavy scale during December to relieve seasonal pressures on the banks and to insure a successful result for the Treasury's $12.2 billion December refunding and $1½ billion cash borrowing. For the first time since September 1952 the Federal Reserve entered the market in direct support of a Treasury refunding, acquiring on a when-issued basis $167 million of the new one-year 2⅝ per cent cer-

tificates due December 1, 1956. Federal Reserve purchases of government securities, from November 23 to December 21, reached $750 million and introduced sufficient funds into the market to spare the banks from needs to increase their borrowings.



Member Bank Excess Reserves and Borrowings, 1951-55
(Monthly averages of daily figures)

The experience illustrates the difficulties of maintaining full pressure on the market during periods of Treasury finance and serves as a reminder of the usefulness, whenever practicable, of stretching out debt maturities and reducing the frequency of Treasury maturities.

In January the Reserve Banks no doubt will be selling government securities on the usual heavy scale to counteract easing tendencies from return flow of currency and loan repayments. A further ¼ per cent discount rate advance, forestalling seasonal decline in short-term open market rates, would be no great surprise.

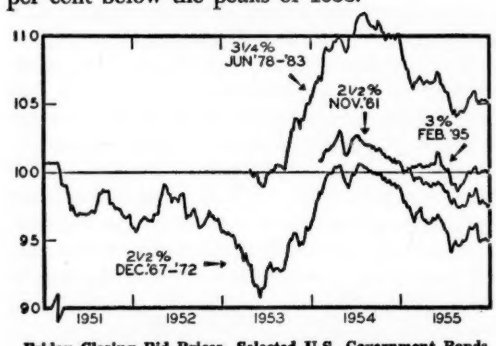
Bond Market

While 91-day Treasury bills pivoted up to 2.69 per cent, the forty-year Treasury 3s held to a par level. This made the flattest yield curve we have had in twenty-two years, and aroused some consideration of the possibility that 1956 might see bill yields at some stage passing bond yields. Treasury bonds shorter than the 3s, all the way down to six-year maturities, clustered around a yield level of 2.90 per cent. On an after-tax basis to a corporation, as a matter of fact, the highest yield on any Treasury obligation toward the close of December was the 1.62 per cent offered on the 1⅞ per cent notes maturing February 15, 1959, not much more than three years away.

While long Treasury bonds held steady, corporate bonds tended to decline in price and improve in yield, restoring more normal spreads over Treasury yields. New offerings rated Aaa or Aa by Moody's Investors Service were floated at an average return to the investor of 3.31 per cent. As recently as early November some issues of top grade corporates were being taken by investors on a yield basis of 3.20 per cent. Corporate bond yields, nevertheless, remain far below the levels reached during May and June of 1953 when top-grade new issues had to pay 3¾ per cent.

Offered yields on high-grade state and local government bonds, partly reflecting an over-inventoried position of dealers, also have had to be advanced to develop better investment demand. For example, an issue of New York Thruway Authority bonds in October paid 2½ per cent; a similar issue in December paid 2¾ per cent. In May or June of 1953 a bond of this quality, to find a buyer, would have had to pay more than 3 per cent.

For bonds generally, yields remain ¼ to ½ per cent below the peaks of 1953.



Friday Closing Bid Prices, Selected U.S. Government Bonds
(Last plotting for Thursday, December 29)

The contrast with 1953, when a restrictive credit policy had a heavy impact on bonds, has occasioned widespread comment. The increasing buying power of pension funds figured in the stability of the bond market last year, though it is normal for bond yields to move much more narrowly than short-term rates. The 1953 decline in bonds took place in an environment of fears that credit would tighten to the point of suffocation. The Federal Reserve Banks were putting pressure on borrowing banks and bonds were being pressed on a market that lacked experience with the reversibility of credit policy and failed to appreciate the buying op-

portunities presented. In 1955, banks found the Federal Reserve's discount facility more willingly available and, while absorbing considerable losses, did not feel it necessary to press sales at times when little buying interest was apparent. The 1955 bond market had seen, during 1954, a radically easing phase of flexible credit policy, and recognized that the time would come when restraint would be lifted and bond prices would again benefit from bank buying power.

Shifting Ownership of Public Debt

In prosperous times when credit policy is restrictive banks benefit from higher loan demands and better interest rates but are under pressure to sell bond investments even though losses may be involved. Contrariwise, in less prosperous times loan income shrinks and banks need to put excess funds to work in bond investments even though prices are high and yields low. Greater stability in bonds is certainly welcome to banks, as to other bond investors, after the radical swings of the past three years.

On the basis of Treasury estimates, banks added \$4.5 billion to their investments in U.S. obligations under easing money conditions in the year ended September 1954; they sold \$5.0 billion under tightening conditions in the year ended September 1955. Where these securities came from, and where they went, is brought out in the following tabular analysis:

Shift of Ownership of U. S. Government Securities Under Reversing Credit Policies

(Billions of Dollars)

	Holdings as of Sept. '55	Changes, Years Ended Sept. 1955	Changes, Years Ended Sept. 1954
Total Outstanding	\$277.5	\$+2.7	\$+1.8
Official Accts. and F. R. Bks.	75.0	+1.3	+0.5
Total Private	202.5	+1.4	+1.3
Commercial Banks	62.1	—5.0	+4.5
Mutual Savings Banks	8.7	—0.2	—0.6
Life Insurance Cos.*	9.1	——	—0.8
Fire, Casualty, etc. Ins. Cos.†	5.9	—0.1	——
State and Local Govts.	15.1	+1.3	+1.1
Corporate Pension Funds	2.2	+0.2	+0.1
Nonfinancial Corporations	20.9	+2.8	—1.9
Foreign and Int'l Accounts†	7.2	+0.9	+0.5
Individuals			
Savings Bonds	50.2	+0.5	+0.4
Other	15.6	+0.9	—1.8
All Other Investors†	5.5	+0.1	—0.2

Source: U. S. Treasury except where otherwise noted.
* Institute of Life Insurance.
† Estimated by this bank.

Changes in the public debt do not particularly affect the comparisons. Obligations in private hands (outside of official trust funds and the Federal Reserve Banks) increased a little less than \$1½ billion in each of the two years. Under the easing money conditions of the year ended September 1954, sellers of government securities were nonfinancial corporations, individuals, life insurance companies and savings banks. Short-term securities were disposed of in favor of cash when they failed to earn enough interest to justify the trouble of investment. Long-term securities were sold to realize capital gains and to make mortgage and stock investments.

Under tightening money conditions in the year ended September 1955, nonfinancial corporations and individuals returned to the market as buyers, taking advantage of the better yields available and possible future capital gains. Life insurance companies and savings banks, discouraged by declining bond prices, slowed or stopped their selling, and tailored their mortgage lending closer to incoming flows of saving. Corporate pension funds, state and local governments (mainly for pension and sinking funds), and foreign and international accounts increased their holdings in both years.

Thus it is clear that the market has learned quickly, though not without pain, how to live with a flexible money policy.

For "Stable Growth"

"To foster stable growth" is widely accepted today as the proper objective and responsibility of the government's economic policy. In the perspective of the violent economic fluctuations we have suffered at times in the past, the last few years have been almost too good to be true. During the early postwar years we enjoyed growth and also moderation in business fluctuations but we failed to find monetary and fiscal policies that would give us price stability. The Korean War inflation led us to unpeg the bond market and give greater scope and flexibility to monetary policy. Cutbacks in federal expenditures enabled us in 1954 to get rid of the excess profits tax, to widen depreciation options for all types of business, and to stimulate private spending and enterprise. The 1955 boom has raised the tax base and revenues sufficiently to bring a balanced budget within sight for the first time in five years.

Since 1952 we have successfully ended the Korean War, freed our markets from arbitrary controls, stimulated the wants and energies of our people, given them more efficient tools to spare labor, and built incredible numbers of new homes and cars, not to mention products practically unknown even ten or twenty years ago. When people accept the fact that wonders will never end, we are in an era of forward-looking optimism.

This is the season for New Year's resolutions and appraisals of 1956 business prospects. Con-

fidence abounds, inspired by the 1955 performance, by the disposition of the Administration and Congress to reduce taxes as soon as possible, and by knowledge that the Federal Reserve stands ready to ease the availability of credit if more money is needed to keep the economy going full blast.

It is an easy time to get carried away, as we have been carried away before, to lose balance and perspective, to become cocksure and careless. A sensible optimism is an essential to prosperity. Optimism running to uncontrolled excess has been our historical path to disaster. To be sure, this new era is different from anything previously experienced in history. But this may not save us from the consequences of raising our aspirations and expectations beyond possibility of fulfillment, and suffering the inevitable disappointments. Markets, populations, prices and profits have practical limits and at some point must fail to match the soaring fancies of the human mind.

The best New Year's resolution is to avoid counting too many unhatched chickens. Though not generally adopted, this was the best resolution for 1920, 1929, 1937 and 1953. If we hold to it, another year of bounteous prosperity lies within grasp. We need balance and discretion among the leaders of industry, agriculture, and labor, and the people generally. More than that we need to have sound, constructive policies on the part of government. Unsound policies of government are an irresistible inducement to unsound policies throughout.

On the surface, government policies seem admirably adjusted to the needs for stable growth and unrivalled prosperity. If prosperity is to be prolonged, public policies will have to be sensitively adjusted, not only to short-run fluctuations, but also to corrosions going on insidiously beneath the surface.

A Look Back

We may already have a bear by the tail. Back in 1953, a restrictive credit policy, along with scheduled curtailments of government outlays and deferment of tax reduction, burst a bubble of overoptimism. In the 1954 business recession we had tax reductions to support spending, and the Federal Reserve pushed the credit-expansion accelerator to the floorboard. The easing back on the accelerator in early 1955 was gentle and lenders did not get the feel of the brakes until summer.

Perfect timing in credit policy changes cannot be expected. Statistics for the most recent weeks and months are tentative and subject to considerable corrections. But developed momentum constitutes a problem. The most threatening developments of 1955 were the upsurge of business optimism, dramatized by the steep rise in stock prices and generous wage settlements, and the acceleration of home-building and car-buying with borrowed money. Demands upon many markets exceeded productive capacities, leading to overtime, labor shortage, industrial price advances, enlarged plant and equipment programs, and increased needs for savings at a time when people were more disposed to borrow and spend than to save.

We needed a shock. We got one, from a totally unexpected quarter, in the distressing news that the President, on September 24th, had suffered an illness that might result in his unavailability for renomination and reelection. Business optimism was founded in part on the assumption that we would continue to enjoy his wise leadership and policies for an additional four years. In general people went ahead. But they became more inclined to stop and reassess the soundness of the economic position.

The prosperity we have enjoyed did not come by accident, although we have had fortuitous factors in our favor. We have adjusted monetary and fiscal policies to what seemed to be, on examination, the needs of the time. But we can continue to prosper only by the same conscientious attention to things that are wrong or going wrong, giving heed to unhealthy symptoms and the rules we must follow to protect solvency and stability.

The Inflation Virus

We may have a little too much inflation virus in our blood. We have been too tolerant of the build-up of debt. It is true that rising incomes increase debt-carrying capacity. It is true that our accumulating national savings need to be put to productive use and that this entails a willingness of home-builders, industry, and government bodies to borrow. But when our collective desires to borrow exceed our desires to save we are economically unstabilized. We find that, to finance our ambitions, unwholesome amounts of Federal Reserve credit have to be drawn into use and that business, to satisfy our desires, is bidding more for labor and materials and raising prices. After all, as the metal markets have been saying, there are limits to what we can undertake at one time.

Some people feel that chronic mild inflation is the way to perpetual prosperity as it is to easing debt burdens. The truth is that inflation is a tax on the savings of the poor, an impedi-

ment to orderly forward planning, and the harbinger of crisis and depression. Nations experiencing chronic price inflation like England and Sweden find inflation a political liability and struggle by one means or another to stop it. No one in this country has ever won a Presidential election on a platform advocating inflation.

In a speech December 29 before the joint annual meetings of the American Economic and Finance Associations, Allan Sproul, President of the Federal Reserve Bank of New York, referred to "the siren song of gradual modest inflation" and asked the assembled economists for aid "in resolving doubts about our ability to combine a stable dollar with a growing, expanding high level peace-time economy":

> We are pretty much all of one mind, I take it, when it comes to opposing deflationary forces which threaten a waste of human and material resources. But there is no such unanimity when inflation — usually trotted out as mild inflation — is in prospect or in being . . . The siren song of gradual modest inflation, if it be that and not the music of the spheres, appeals to many groups, political and economic. There is a tendency to relax and enjoy the sound of more money in the cash register, and the appearance of more dollars in the balance sheet and in the pay envelope . . .
>
> There are those, of course, who think . . . that our powers have been reduced to exerting a gentle tug on the reins from time to time, which is really administered by the horse. With that I cannot agree; I cannot bear witness to the impotence of our central banking system. It still has considerable power, even though we recognize, as I think we must, that general monetary controls can no longer be used so drastically as to bring about a severe restriction of the money supply with restriction of income, production, and employment in its wake. In this we would only find support if we were faced with a runaway inflation due solely or primarily to monetary causes. That is an emergency we have not had to face, and certainly do not have any desire to face, even though the actual experience of such a catastrophe might subsequently make for broader public understanding of the anti-inflationary steps we must take from time to time.
>
> In developed countries which have experienced hyperinflation the central bank has only to mention the word inflation to bring a large measure of public support to a restrictive credit policy. When we mention inflation as a reason for trying to restrain a boom, which shows signs of temporarily exhausting physical capacity to increase the supply of goods and services, and in circumstances when further injections of bank credit are likely to show up largely if not entirely in increased prices, we are apt to be charged with crying wolf when there is no wolf, to be denounced as apostles of deflation.

The Unbalanced Budget

The chronically unbalanced federal budget gives specific cause for concern. Indulgence of excessive government spending and public deficits has never been consistent with stable growth. With all due respect to the necessities of a strong military establishment, to the increase in the functions performed by governments, and to the needs for more schools and better roads, it does seem that federal spending policy is still oriented toward the idea that the economy is "mature" and would be "stagnant" if the government did not apply heavy taxes to insure that money would get spent. The actual experience is that the inventors and salesmen can turn up new things for people to buy faster than the breadwinner — after tax — can pay for them. So he stretches his credit to the limit to compete with governmental demands upon the markets and to replenish income the government abstracts from his purse.

Twenty years ago people — at least those whose taxes had not yet been increased — excused extravagance in government because it put money in circulation. We had a proliferation of Federal Government activities and agencies. We still have most of them plus a vast complication of our defense needs — the number one Federal Government responsibility. We also have a problem of federal budget control that produces many proposals for amelioration, each open to serious objections. The real question — and the President's illness gave it point — is whether the Federal Government establishment has not grown just too big for correlated human control. The obvious solution is for the Federal Government to concentrate its energies on the things that must be done on the Federal level and leave the rest to the responsibility of the individual, of private enterprise, of state and local government bodies. After all, as E. B. White once wrote, the American theory is that the individual is a very competent little guy.

There are manifold reasons for laying stress on controlling Federal Government outlays at the present time. Prosperity generates heavier revenues, and the natural tendency of Congress is to take a more relaxed attitude toward appropriations. Helping the States enlarge road and school programs has been suggested. This might be sensible if labor and steel and cement supplies — and surplus savings — were going to waste. As it is, more Federal Government borrowing and spending will simply augment upward pressures on prices and levy an inflation tax on the savings of the people.

The Tax Question

Before enlarging outlays, the Federal Government should be paying down some public debt. If we cannot pay down public debt in the most prosperous era of our history, when are we going to? Should there be money to spare

the most imperative need is to give attention to the corroding influences of excessive income tax rates.

The President's recommendations on taxes, in his annual messages to Congress in January, will be awaited with great interest. As the law now stands, on April 1 the 52 per cent corporate income tax rate will drop to 47 per cent, and excise taxes on automobiles, gasoline, tobacco and alcoholic beverages will be lowered. The general assumption is that these taxes will be extended at present levels so that any leeway for tax reduction can be applied to easing the personal income tax burden.

The 52 per cent corporate income tax, a "temporary" rate that has been extended and re-extended, is unequalled among major countries. Fifty per cent is a critical point in income taxation. For successful corporations, rates this high breed extravagance in deductible expenditure categories. A tough, tight chief executive officer may hold the line but the temptations and pressures within his organization are against him. Such a scale of corporate income tax, aggravated by the personal tax on dividends, creates a powerful inducement to the sale of bonds rather than stocks to finance expansion and thus adds to the rise in debt.

A tax is hardly on sound ground that makes government the prime beneficiary of private enterprise, taking more than half of net profits and often as much as double the dividends to the shareholder, and laying a foundation for the political argument that deductible expenditures by corporations represent appropriations of the public revenues without approval of the Congress.

At the same time, cuts in the corporate rate must be gradual. Unlike corrections of the higher personal rates, where there is little to lose and much to gain, corporate rate cuts are expensive.

The Congressional Joint Economic Committee last March appointed a Subcommittee on Tax Policy, headed by Congressman Wilbur D. Mills of Arkansas, to conduct a study of federal tax policy for economic growth and stability. In November the subcommittee published a 930-page compilation of papers submitted by experts from the universities, business, and labor organizations, and in December held hearings. While a number of the experts advocated a cut in the corporate tax rate, the main emphasis was on the vices of the personal income tax, particularly the growing loopholes which comprise the natural escape of a dynamic economy from tax rates dedicated to socialism.

Personal Rates

Successful people devoted major portions of their incomes to the common cause during the depression and war emergencies. For normal times, as public opinion polls have indicated, there is little support for income tax rates as high as 40 per cent, let alone the 80 and 90 per cent rates still in our statute books.

People naturally press for reliefs which, when enacted, take a form bound up with legalistic restrictions and understandable only to a Philadelphia lawyer. Without expert help people do not get the tax savings intended for them. The time spent studying law, probing for legitimate deductions, and testing in the courts how far the law can be stretched, is stupendous.

Congress has no less an authority than Randolph Paul, legal counsel to the Treasury in the Roosevelt Administration, for the view that rates need to be corrected to stop the process of erosion. He told the Mills subcommittee:

> This process of erosion and patchwork amendment must stop somewhere; otherwise the statute, even now almost hopelessly complicated, will approach the ridiculous, and taxpayers will have to spend more and more of their time and energy on the job of keeping their tax liability at a minimum.

Nevertheless, Congress shies away from the rate problem as though confiscatory income taxation were an essential part of the American tradition. Finance ministers in other English-speaking nations have moved away from extremes of taxation, won increased parliamentary majorities, reenergized the spirit of enterprise, and opened vistas of economic abundance. If we do not wake up we may find that we have killed the goose that has laid our golden eggs.

Every time any suggestion is made that the rates should be cut someone gets out a pencil and calculates how much the Government would be "giving" to some theoretical millionaire who has not taken the trouble to inform himself of the legal means by which he may reduce or control his tax liabilities.

Trade union leaders, among whom have been the prime advocates of taxation to take the joy out of wealth, are taking greater cognizance of ways to save on income tax. Their recent stress on "fringe benefits" has its tax-saving angles. Nevertheless, union leaders — and Democratic leaders in Congress likewise — urge the $600 personal exemption as the main fault of the income tax. They would raise the exemption to $700, for a revenue loss of around $2½ billion a year, to increase consumer spending. Yet we have no shortage of consumer spending. We do face a shortage of savings. And we do have

an acute reason to reform a tax rate structure that breeds disrespect for the law.

Attitude Toward Enterprise

Fiscal matters are recorded and discussed in figures. It has ever held true that high and increasing government expenditures and deficits breed inflation; that excessive taxes and surpluses breed deflation. But the actual contours of business and prices over periods of a few months or years show no systematic response. Fiscal policy is something more than can be recorded in tables and charts. It operates on human nature, on human hopes and fears, and on human decisions what to do with the money we have or can borrow. Fiscal policy expresses the attitude of government toward money and toward enterprise. Unless enterprising people risk capital in ways that provide jobs, neither they nor their employees have income to tax.

Forward-looking businessmen and investors work on conceptions of what tomorrow's taxes and business climate will be. It is where fiscal policy is pointed that counts. To illustrate, the present business boom had foundations in the tax reliefs and reforms of 1954, and in the decisions against pump-priming government outlays. The Administration kept a balanced budget in sight, fortified confidence in the stability of the currency and economy, and encouraged hopes of further sensible and equitable measures of tax relief. The exact timing of such measures is less vital than the reasonable expectation that they are inevitably coming and within a balanced budget so that they can be sustained.

The question is, where do we go from here? In the postwar period we have restored the flexibility of credit policies and public debt management. The heavy revenue requirements of the Federal Government — and the objective of balancing the budget — have limited what could be done on the front of tax stimulations. Hence we have had to rely, for high level employment, predominantly on easy money policies and build-up of private, state and local indebtedness.

The soundest course of policy is to use tax stimulations when the economy lags — though without removing the prospect of an over-balanced budget in prosperous years — and rely less on abnormal stimulations of borrowing. Tax cuts that invite people to spend and invest their own money more freely, or to switch efforts from realizing capital gains and deductions to realizing taxable regular income, can support employment and production and add to the revenues.

There has been a lot of anticipation of tax reductions in 1956. Some people are talking of tax cutting to win votes, without regard to any needs of the economy for stimulations, consequences in terms of inflation, or the revenue requirements to cover outlays. This would be a remarkable course for a country that has world leadership to lose by irresponsible finance.

Even more incredible is the idea of excusing more people from the income tax rolls and leaving the present rates unchanged. This would chuck revenue away without adding an iota of incentive to the economy, dash the incentive that is based on longer-range expectations of a better, sounder, and fairer deal on rates, and multiply the pressures for tax avoidance. It is to be hoped that any Administration taking office in 1957 will concern itself with the necessities of an honest and fair tax system, as well as the need for private enterprise and private capital, to provide 65,000,000 jobs and sustain economic growth.

Farm vs. Retail Food Prices

The renewed weakness in farm prices, particularly of beef cattle and hogs, in the past few months has stirred fresh controversy over "marketing spreads" — the difference between what the farmer gets and the consumer pays. Even Secretary of Agriculture Ezra T. Benson has entered the discussion. In an address before the Farm Equipment Institute in September, Mr. Benson charged both industry and labor with having gained at farmers' expense. Noting that farmers have been squeezed in the past four and a half years between "inflexible" high operating costs and declining farm prices, he declared:

> Throughout this period a considerable part of the increased profits that have gone to industry and the higher wages that have gone to labor have been siphoned from the economic bloodstream of the nation at the expense of agriculture.

Referring especially to "some segments of the food industry", he went on to say:

> Constantly widening margins — forced by higher wage, transportation and handling costs — have prevented consumers from enjoying the savings which would otherwise have stemmed from increasing agricultural productivity and efficiency, and lower farm prices.

On December 9 the Secretary announced that, in an effort to learn why the farm price decline has failed to benefit the consumer, he had instructed the Agriculture Department experts to step up their studies of marketing margins and farm production costs. On December

22, in the first of a series of reports to follow, the Department announced preliminary findings.

Retail food prices in November, it was stated, were less than 2 per cent below November last year although farmers had taken a 10 per cent reduction in their prices. Over the year, it was estimated, marketing and handling charges increased 5 per cent. Farmers, the report said, "are now getting only 39 cents out of every dollar spent for food in the retail store", the smallest since 1940. This compares with a peak of 53 cents in 1945 and 42 cents in November 1954.

The following table from the report shows changes in the farm and retail prices of a "market basket of farm foods" and major items therein for the periods indicated. The differences between them, or "spreads", represent the changes in marketing costs.

Recent Price Changes in the Food Market Basket

		November 1954 to November 1955			Third Quarter 1955 to November 1955		
Commodity	Retail Quan.	Retail Cents	Farm Cents	Spread Cents	Retail Cents	Farm Cents	Spread Cents
Bread	1 lb.	+0.3	— 0.2	+0.5	+0.1	+0.1	0
Butter	1 lb.	—0.4	— 0.3	—0.1	+0.4	+0.8	—0.4
Milk	1 qt.	+0.4	+ 0.1	+0.3	+0.7	+0.5	+0.2
Eggs	1 doz.	+7.8	+ 9.8	—2.0	+1.6	+4.0	—2.4
Chickens	1 lb.	+0.9	+ 1.9	—1.0	—4.9	—5.7	+0.8
Pork	1 lb.	—6.6	—10.3	+3.7	—5.9	—6.8	+0.9
Beef	1 lb.	—4.0	—10.1	+6.1	—1.4	—3.1	+1.7
Potatoes	15 lb.	—7.6	— 6.8	—0.8	—6.4	+1.2	—7.6
Market Basket (67 items)		—$12	—$39	+$27	—$21	—$22	+$1

Note: The farm value is based on the quantity of farm products equivalent to the quantity at retail.

Summarizing these findings, the report said:

> Pork and beef stand out as commodities for which marketing charges have continued to rise while too-abundant production drove down the farmer's price. Consumer costs for pork and beef have declined less than the drop in farm prices. For potatoes, on the other hand, the price spread has been substantially narrowed.

A Mixed Showing

Figures cited by the Department of Agriculture as evidence present a mixed showing. Of the eight "market basket" commodities listed, four in the November to November comparison show retail prices falling *faster* or rising *slower* than farm prices — with an actual *narrowing* of the "spreads". In the comparisons of November '55 with the third quarter of '55, three of the eight items show similar changes, with one showing the farm and retail price change the same.

For the "market basket" of 67 commodities as a whole, the prices in November 1955 showed an increasing spread as compared with November '54 but practically no change as compared with the third quarter of '55.

Moreover, price composites such as the Department of Agriculture's "market basket", even when broken down as in the table above, don't tell the whole story. The next table, comparing prices of various meat cuts in New York City in December and at the post-Korean peaks (mainly in '51 and '52), shows what every housewife who shops carefully must know — that retail prices in many cases have come down substantially:

Changes in New York City Retail Prices of Selected Meat Products, Post-Korean War Peaks to Week Ended December 15, 1955, in Dollars per Pound.

	Post-Korean Peak	Week Ended Dec. 15, 1955	Percent Change
Porterhouse steak	$1.32	$1.10	—17
Sirloin steak	1.24	0.89	—28
Chuck steak	0.81	0.49	—40
Chopped beef (regular)	0.69	0.45	—35
Beef kidneys	0.39	0.25	—36
Oxtails	0.43	0.29	—33
Beef liver	0.91	0.59	—35
Veal cutlets	1.50	1.29	—14
Veal shoulder roast (bone in)	0.65	0.45	—31
Veal leg and rump	0.89	0.65	—27
Veal breast and neck	0.53	0.35	—34
Pork loin roast	0.79	0.45	—43
Pork loin chops (center cut)	0.98	0.75	—23
Smoked hams (regular)	0.75	0.55	—27
Sliced bacon	0.98	0.69	—30
Lamb loin chops	1.35	1.10	—19
Leg of lamb	0.85	0.59	—31
Lamb breast and shank	0.39	0.19	—51

Source: Department of Markets, City of New York, Bureau of Consumers' Service and Research. Figures are for generally prevailing prices.

Such declines, running to 40 per cent and over, contrast sharply with the "market basket" type of comparison, and belie the contention that almost none of the lower prices received by farmers has been passed on to the consumer.

Moreover, in many items there are frequent special sales, as well as wide variations in regular prices even in the same neighborhood, of which the alert housewife can take advantage. No one compels her to pay top prices when bargains are available elsewhere.

Why Prices Are Sticky

Many people may not realize that retail price indexes include products, such as packaged cereals, canned goods, frozen fruits and vegetables, etc., which can hardly be expected to fluctuate closely with farm prices. More and more we are becoming dependent upon such products. As Secretary Benson aptly put it, in some of our foods we have what amounts to "built-in maid service".

All these steps cost money, but help to give the consumer the kind of goods and services wanted.

In view of the importance of labor costs in food processing and marketing, comments by

labor spokesmen on the marketing spreads are noteworthy. The statement by Walter Reuther, President of the CIO, before the House Agriculture committee last February that "we know that most of the price we pay for food does not go to the farmer" is an example. Another is an editorial on "The Farmer's Plight" in the November 4 issue of the AFL News-Reporter citing the Department of Agriculture figures on the farmer's declining share of the housewife's dollar.

With wages in food processing and marketing doubled since 1945 (not including greatly increased indirect labor costs such as insurance, pensions, supplementary unemployment benefits, etc.), it is not hard to see where more of the housewife's dollar is going.

Another factor to be considered in making food price comparisons is that in periods of heavy livestock marketings the less popular meat cuts are the ones with the greatest price declines. For instance, a retailer will hold the price of steaks if he finds he can move them while he cuts prices substantially on boiling beef, etc., in order to keep all products moving which he cuts out of the carcass. Thus the decline in the wholesale price of a carcass may not be reflected in certain cuts. Nor is there any reason why it should be. The fundamental adjustment is through the response of consumers and retailers to the quantities of individual products which must be moved.

With the record-breaking levels of employment and personal income, the public prefers to buy the choicer cuts of meat and the more expensive grades of food generally. Whereas regular chopped beef and chuck steak can be purchased at prices down 35 to 40 percent, the public still demands porterhouse steaks, lamb chops, and veal cutlets at over $1.00 per pound, which accounts for their prices being down only 14 to 19 per cent from the peaks.

But again, who is to complain if that is the way the customer wants to spend his money?

The Farmer's Primary Interest

Finally, it is in order – in view of the talk about "marketing spreads" and the farmer's "declining share of the food dollar" – to challenge the theory that the farmer's welfare is necessarily affected adversely by such spreads.

After all, what the farmer is interested in is not so much these "spreads" as the dollars he actually gets for the products he sends to market. If he is doing an efficient production job, and the dollars he receives represent a satisfactory return on his labor and investment, it is a matter of secondary importance to him whether these dollars constitute a smaller or larger proportion of what the consumer pays.

Certainly it is to the advantage of all concerned to keep costs of distribution as low as possible. But with labor and other costs steadily rising this is a constant battle all along the line. We have referred to the increasing amount of processing called for in food retailing today. Naturally this costs money, and if the customer continues to require and is willing to pay for more and more of such services and conveniences the margin between farm and retail prices may grow still wider.

To the extent, however, that the addition of such services and conveniences, plus advertising, promotion, etc., broadens the farmer's market and enables him to sell more of his product, he stands to gain, not lose. For example, the acceptability of frozen fruit juice concentrates has raised citrus consumption, and the rapid expansion in the sale of frozen foods generally testifies to the effectiveness of the convenience appeal.

The trouble today from the standpoint of the farmer is not the "marketing spreads" but the fact that current supply-demand relationships put him at a relative disadvantage. In buyers' markets, marked by plentiful or excessive supplies and falling prices, sellers are always at a disadvantage, just as in periods of short supplies and rising prices they have their innings. In this respect, the position of the farmer is not different from that of most other businessmen.

Once supplies of farm products are tailored to market requirements, the pendulum may be expected to swing the other way. This, however, can hardly be expected to come about so long as price supports for farm products which encourage the accumulation of burdensome surpluses are maintained.

w York

OF
AMA
nama

DI ARABIA
idah

APORE
ngapore

GUAY
ontevideo

EZUELA
racas
guina
anta Capilla
Miranda

ovia

..ed in U.S.A